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SUBJECT: MEXICAN RAILROAD COMPANIES DERAILED FROM MONOPOLISTIC ASPIRATIONS

REF: MEXICO 1307

11. (SBU) SUMMARY: On June 24, cargo railroad companies Ferromex and Ferrosur were found guilty of monopoly practices and slapped with the maximum fine allowed under Mexican law (roughly equal to US\$ 6 million each) by Mexico's anti-trust watchdog agency, the Federal Competition Commission (CFC). CFC also sanctioned the main shareholder groups in both companies as well as all the other actors involved in the transaction for a total fine of 419 million pesos, or US\$ 31 million. This is a significant step in the maturation of Mexico's anti-monopolistic efforts, and it should not go unnoticed that among those shareholders sanctioned is Mexican tycoon Carlos Slim. END SUMMARY.

12. (U) In the mid-1990s, Mexico's state-owned railroad network was privatized and divided into four different systems to avoid a monopoly. Talk of mergers has been a staple ever since. Carlos Slim's Ferrosur quickly consolidated two concessions, including the heavily-trafficked Mexico City to Veracruz line. Mining entrepreneur Jorge Larrea formed Ferromex with minority partner Union Pacific and took the west coast network from Mexico City, Manzanillo, and Guadalajara to Sonora. The central-north concession went to U.S. tier one railroad Kansas City Southern. Ferrosur, Ferromex, and Kansas City Southern's Mexican filial (KCSM) jointly own the Ferrovalle system around Mexico City.

13. (U) A first Ferromex-Ferrosur merger attempt failed in 12002. The railroads tried again three years later, when in November 2005, Carlos Slim sold the profitable Ferrosur to Ferromex for US\$ 360 million. The two companies notified the CFC of their intention to merge, and the following day completed the merger without awaiting analysis of the transaction and a legal decision by the watchdog agency. Rival KCSM objected and appealed to the CFC to block the combination. In June 2006, the CFC rejected the merger, stating it would have led to excessive concentration in the railroad industry to the detriment of consumers and competing shippers. In April 2007, the Mexican Supreme Court upheld the CFC's decision, and in August 2007 the anti-trust agency embarked on investigations into whether the two firms fixed prices and engaged in other anticompetitive practices.

14. (U) Last week, the CFC announced its decision, to the delight of advocates for increased competition in Mexico as well as KCSM. The investigation "produced sufficient evidence to note that, despite the prohibition of the merger, both companies are coordinating their operations and specifically, they have exchanged information with the objective of concerting pricing," states the final decision. It fined all

the actors involved in the transaction, including Ferromex, Ferrosur, Grupo Mexico (Larrea's shareholding company that owns 74 percent of Ferromex), Grupo Carso (controlled by Slim, one of the two shareholding companies that owned Ferrosur), and Inbursa (the second owner of Ferrosur, also controlled by Slim). Each received the maximum fine allowed under Mexican law - 82.2 million pesos, or roughly US\$ 6 million. Other companies sharing the fines included Lineas Ferroviarias de Mexico, Grupo Ferroviario Mexicano, Infraestructura y Transportes Mexico and Infraestructura y Transportes Ferroviarias, each with ties to the two Mexican business moguls. The total fine is the highest in Mexican history - 419 million pesos, or US\$ 31 million. CFC also ordered both companies to separate and return to the original concession status they were awarded in 1998.

¶5. (SBU) As for next steps, Mexico's Tax Administration (SAT), and not CFC will be responsible for collecting the fine. The media report that sources close to Grupo Mexico will file an injunction against the decision; Grupo Carso did not comment. "There is no doubt that [the nine actors] will try to do something," CFC's Director General for Institutional Relations and International Affairs Kenneth Smith told ECONOFF. "It's pretty clear that they engaged in collusive practices, and they're going to attack the procedure but they can't attack the decision."

¶6. (SBU) Smith commented that Ferrosur and Ferromex simply miscalculated. We will never know why the two groups felt they had to move quickly to merge at the risk of ignoring government regulations, he said. But they must have thought

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the worst punishment they might incur would be a "slap on the wrist" for an illegal merger. According to Smith, what they failed to realize was that following the CFC's 2006 decision not to authorize the merger, both were in violation of Article Nine of Mexico's Federal Economic Competition Law (FECL), which prohibits the practice of such monopolistic activities as price fixing and other collusive efforts.

¶7. (SBU) ECONOFF asked Smith how the proposed amendment to Mexico's FECL currently under consideration in Mexico's Senate (see reftel) would alter the CFC's decision. Certainly, he said, if the amendment was in place today it would raise the fines - the punishment to the five key players is the maximum allowed under current law. The proposed amendment would allow the CFC to fine violators up to ten percent of that company's annual sales.

¶8. (SBU) Smith said that CFC has launched two initiatives recently that while not directly related to this case, would certainly impact future merger proposals in Mexico. He estimated that 99 percent of all proposed mergers in Mexico are authorized by CFC. He said that the watchdog agency was working to reform its internal process to allow for some mergers to be decided in a more expedited fashion, similar to the FTC's fast-track procedures in the United States. CFC is also working on its benchmark analyses to measure the competitiveness of a market. The current system is sufficient to measure the impact of a proposed merger on a large market, but needs more refined tools to measure a smaller market.

¶9. (SBU) COMMENT: This is a significant step in the maturation of Mexico's anti-monopolistic efforts and the development of Mexico's anti-trust watchdog agency. CFC is becoming an effective tool to stimulate competition in Mexico, and is not afraid of taking on Mexico's wealthiest tycoons, including Carlos Slim. Congressional approval of the proposed amendment to the FECL will add more teeth to CFC's bite. This will be especially important if the Calderon administration decides to go after Mexico's monopolies and oligopolies and remove these impediments to Mexico's growth in the remainder of its sexenio. END COMMENT.

FEELEY